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STATE FOR WHA/BSC, WHA/EPSC AND GREG MANUEL
STATE FOR EB/ESC BRIAN DUGGAN, U/S REUBEN JEFFREY
USDOC FOR SECRETARY GUTIERREZ,
USDOS FOR 4332/ITA/MAC/WH/OLAC/JANDERSEN/ADRISCOLL/MWAR D
USDOE FOR DEPUTY SECRETARY JEFF KUPFER/CAROLYN GAY/RHEA DAVIS

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SUBJECT: OIL RESTRUCTURIN: AMBASSADOR TALKS TO ENERGY MINISTER LOBAO

REF: A) RIO DE JANEIRO 138, B) RIO DE JANEIRO 135, C) RIO DE JANEIRO
91, D) RIO DE JANEIRO 35, E) 07 SAO PAULO 0953

Sensitive but unclassified, please protect accordingly.

1. (U) SUMMARY: As Brazil debates the revision of its oil exploration fee structure in light of its newly discovered presalt reserves, it is clear that the Ministry of Mines and Energy, tasked with making a recommendation to the President, will advise the formation of a new state entity to own the reserves and contract out to service providers in a production-sharing agreement. In a meeting with the Ambassador, Minister of Mines and Energy Lobao shared his vision of the production sharing arrangement, dismissing concern over the amount of time that legislative change would take as overstated. Lobao also expressed his interest in having U.S. companies involved in the exploitation of Brazil's oil reserves. Additionally he was enthusiastic about the opportunity to welcome high-level U.S. visitors to Brazil with the intention of developing closer bilateral ties. END SUMMARY.

2. (SBU) The Ambassador and Econoff met with Minister of Mines and Energy Edison Lobao and his deputy, Secretary of Gas and Petroleum Jose Lima Netto, on June 26 to discuss the rapidly developing oil situation in Brazil and what it means for U.S.-Brazilian cooperation. Lobao emphasized that the GOB still doesn't know exactly what the presalt reserves may hold, they are waiting for more information. In the meantime, they have suspended further leasing activities in the presalt area to fully assess the situation. Lobao indicated that he was aware of concerns around delaying the process but it was his assessment that neither domestic nor international companies are ready to exploit these reserves yet. In fact, Petrobras has been limited in its ability to exploit some of the blocks it holds concessions for, even in the non-presalt area, and may soon be obliged by the concession agreement to return the noncommercialized blocks to the regulatory body, ANP to be reauctioned. (Note: Concessions agreements provide 5 years for a block to be declared commercialized or be returned.) With the difficulty in accessing equipment (Ref B), Lobao does not believe that the delay is in fact hampering any would-be development.

LEGISLATIVE CHANGES IN PLAY

3. (SBU) Lobao told the Ambassador that Brazil may move towards the creation of a new company that would own all the presalt reserves, as well as some other areas not already under contract, and would develop these areas through contracts with service providers. Although initially more circumspect in his comments, later in the meeting Lobao stated unequivocally that he intends to propose significant changes to Brazil's current legislation. According to

Lobao, all other countries that have enjoyed major finds had changed their legislation to benefit more directly from their reserves and he believes Brazil should do so as well. In a subsequent meeting, Lima Netto told Econoff one of the primary examples currently under consideration is the Netherlands model, which would create a legal entity solely for the purpose of owning the rights and then contract out to exploration companies. There is currently a working group in place within the ministry studying the legislation of other countries in order to develop a proposal for consideration by President Lula, who will make the ultimate decision. Lobao welcomed Econoff's suggestion that U.S. Mines and Management Service officials who had visited Brazil in May might be available to provide insight into the U.S. regulations.

14. (SBU) In response to the Ambassador's question about the possibility of an extended delay in oil production that would be necessitated by a change in legislation, Lobao opined that the process did not have to be a long drawn out one, as many who oppose the change have suggested (Ref A). Lobao stated that there were legislative options the President could use to quickly push through legislation. (Note: indeed there are a few fast-track options available to the President, including issuing a provisional measure, which has the force of law immediately and must be voted on by congress after 45 days.) Lobao said "we have the ability to, and we must, do this quickly." His plan is to propose the bill this year with the intention of having the new legislation in place by the beginning of 2009.

"Petrol is a Government Issue"

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15. Particularly in light of the possible creation of a new state oil company, the Ambassador expressed his concern that U.S. oil companies in Brazil have focused too much of their energies in building relationships with Petrobras in Rio. Secretary Lima Netto confirmed that the U.S. oil companies had not been frequent visitors to the Ministry, though the Ministry has been in contact with all of the major players in the industry and is looking to meet their concerns while serving the needs of Brazil. Lima Netto acknowledged the importance of Petrobras, but emphasized that "petrol is a government issue," important for the good of the country, not the just the success of Petrobras. Lima Netto further welcomed the idea of future exchanges and was visibly excited when the Ambassador mentioned the possible visit of DOC Secretary Gutierrez. Lobao suggested that not only would such a visit be welcome, but it would be particularly useful if the Secretary were able to bring with him a delegation of U.S. oil companies. They both responded positively to the ambassador's idea that FCS might be instrumental in helping to identify U.S. companies - small, medium, and large - with the type of capabilities Brazil needs both onshore and off, but who are not currently active in the country.

Continuing to build relations

16. (SBU) Lobao was interested in the Ambassador's suggestion that collaboration with U.S. research labs might be an additional area of bilateral cooperation in the non-oil arena. He indicated interest in contacting the Brazilian military about possibly participating in their upcoming meeting with DHS Secretary Chertoff, particularly as it relates to Coast Guard and military discussions on pipeline security. He also expressed his willingness to receive Department of State U/S for Economic Affairs Reuben Jeffery and DOE Acting Deputy Secretary Jeff Kupfer on their upcoming travels, concurring with the Ambassador that it is important to continue building strong bilateral ties during this era of energy expansion in Brazil.

17. (SBU) COMMENT: The debate over the future of Brazil's oil regime is becoming more and more complex. While U.S. oil companies (and the international oil community writ large) prefer the inevitable change in regimes to be based on the current concession structure, with an increase in the royalty percentage that goes to the government, while Petrobras, which stands to lose the most through an increase in royalties, has been pushing for a production-sharing

agreement. Although the regulatory body ANP has voiced its preference for maintaining the current concession structure with increases, it is clear that its supervisory Ministry has something else in mind. Changes in the royalty structure would not require legislation changes, so the fact that Lobao had so clearly voiced his plan on how to proceed with legislation means that he for one foresees the creation of a new company.

18. (SBU) As with so many things in Brazil, this may come down to Dilma. Dilma Rouseff, as former energy minister and current Chairman of the Board of Petrobras, as well as Presidential Chief of Staff and Lula's preferred successor, may well be the one to make the final decision on the government's position. The question of how to maximize return for Petrobras but make the most of the country's reserves for Brazil will be one she must weigh carefully as she fulfills her current responsibilities and weighs them against her future aspirations.

SOBEL